

TESTIMONY OF MICHAEL McERLEAN,

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BEFORE THE COMMITTEE ON AGRICULTURE,

UNITED STATES HOUSE OF REPRESENTATIVES

NOVEMBER 6, 2003

Chairman Goodlatte, Ranking Member Stenholm, distinguished members of the Committee, thank you for inviting U.S. Futures Exchange here today. U.S. Futures Exchange is a U.S. company, whose parent company, U.S. Exchange Holdings Inc., is a 100% subsidiary of Eurex Frankfurt AG, which in turn is owned by Deutsche Boerse and SWX Swiss Exchange. Deutsche Boerse is a publicly traded company listed on the Frankfurt Stock Exchange and is majority owned by UK and U.S. institutional investors. The company is owned by a total of 36,000 shareholders; the largest shareholder is a U.S. institutional investor. Only two shareholders hold a stake larger than five percent; both of these are U.S. entities. SWX Swiss exchange is owned by 55 financial institutions. We are also in negotiations with a broad range of market users as potential shareholders of U.S. Futures Exchange.

We welcome this opportunity to submit testimony regarding our application with the Commodity Futures Trading Commission ("CFTC" or the "Commission") for designation as a new U.S. contract market. We applaud this Committee's continued interest in the integrity and competitiveness of the U.S. futures markets and are pleased to have the opportunity to share with the Committee our plans and to answer any questions that the Committee may have regarding our application for contract market designation.

Congress decades ago recognized the global character of the futures markets and the need for cross-border access to foreign markets, unencumbered by restrictive regulatory constraints. This principle was codified in the Commodity Exchange Act's Section 4b(c), which prohibited the CFTC from regulating access by U.S. persons to foreign markets. This policy proved prescient and has been enormously successful. In this new environment, our U.S. exchange will provide U.S. participants with the same access to foreign products that they already enjoy through remote access to foreign exchanges, with the added benefit that they will be trading through an exchange that wishes to subject itself fully to U.S. regulation, rather than through a foreign exchange operating abroad.

Regulatory Background

U.S. Futures Exchange filed its application for contract market designation with the CFTC on September 16th. As the Committee is aware, the CFTC published our application for public comment and subsequently extended the initial 15-day comment period to 30 days. We have made available for public review and comment significant elements of the materials that we filed in support of our application and have been working cooperatively with the CFTC to provide such additional information as the Commission may request and to resolve issues identified by the Commission. U.S. Futures Exchange endorses the transparency of this process, as it is fully consistent with Eurex's own policy of transparency and responsiveness to

market participants. Accordingly, we consider the public comment period to be an extremely positive and important part of the U.S regulatory framework.

We welcome any comments on our application and intend to respond expeditiously to any and all legitimate issues that may be raised in the process.

U.S. Futures Exchange Business Plan

U.S. Futures Exchange will be based in Chicago. All operations of the exchange will be conducted out of our Chicago headquarters, now under construction, in the Sears Tower. U.S. Futures Exchange will obtain critical regulatory and clearing services from the National Futures Association and The Clearing Corporation (formerly, the Board of Trade Clearing Corporation), also located in Chicago.

In short, U.S. Futures Exchange will operate as a U.S. company, located in the U.S, staffed by U.S. employees, acquiring services from U.S. service providers, and subject – in all respects – to the same U.S. regulatory framework that is applicable to all U.S. futures exchanges.

Our business model has been designed to offer U.S. market participants, customers, and end-users a wide variety of benefits, including enhanced market efficiency, greater market transparency, equal market access and lower costs. To this end, Eurex expects to utilize a modern structure and proven, best of breed, technologies and service providers. Specifically:

1. **Proven market environment.** U.S. Futures Exchange will operate a 20 hour/day all-electronic trading platform utilizing proven, scaleable, state of the art technology developed by Eurex, our European parent. This platform is currently utilized by the Chicago Board of Trade under license from Eurex AG and executes more than 80 % of the volume in the U.S. Treasury Bond futures market through a joint venture between Eurex and CBOT which ends this year. U.S. Futures Exchange will provide market participants access to the same trading environment that the Chicago Board of Trade has been using for the past 3 years and is currently utilizing, under license from Eurex and subject to CFTC oversight, for its a/c/e system.
2. **Open market model.** Access to U.S. Futures Exchange will be available to all market participants who satisfy the exchange's non-discriminatory eligibility requirements. Access will not be artificially restricted to a limited number of market participants who benefit financially and otherwise from restricted membership. All market participants who wish to do so may have the benefit of direct access to the exchange and the exchange's favorable rate structure.
3. **Level playing field; market transparency.** All market participants will have equal access to the market and the same rights in executing their business. There will be no privileges and no physical environment that segregates the direct and immediate access of members from the indirect access of non-members as is currently the case on major U.S. futures exchanges. All market participants will have equivalent access to a competitive and non-discriminatory execution environment. This same environment provides a level of transparency that is equal for all market participants and fosters no informational or other trading advantages to a restricted constituency of insiders.

4. Reduced trading costs. The cost of trading on U.S. Futures Exchange will, on average, be significantly lower than the current cost of trading on the major U.S. futures exchanges. Investors, e.g. U.S. pension funds, will pay 30 cents or less per U.S. Treasury bond futures contract on U.S. Futures Exchange, significantly lower than the CBOT charges. This will result in significant savings for a wide range of market participants. However, as a result of the greater competition that U.S. Futures Exchange will bring to the market, we fully expect that all U.S. market participants – and not just U.S. Futures Exchange’s customers – will ultimately benefit from lower trading costs as a direct result of U.S. Futures Exchange’s market entrance.

5. Additional products. U.S. Futures Exchange will list for trading a broad range of derivatives products including derivatives contracts on U.S. and European interest rates and indices. Availability of certain products will be subject to an arrangement, to be finalized, between our U.S. clearing partner, The Clearing Corporation, in Chicago and Eurex Clearing AG in Germany. These European interest rate benchmarks currently are not traded on any other U.S. contract market. Some of these instruments will, for the first time, offer U.S. market participants and customers the opportunity to manage their European interest rate and equity exposures directly on a U.S. futures exchange.

6. Financial integrity. Clearance and settlement services for all trades on U.S. Futures Exchange will be provided by The Clearing Corporation, a registered U.S. derivatives clearing organization, formerly known as the Board of Trade Clearing Corporation, with whom we have entered into a Clearing Services Agreement. The Clearing Corporation is a venerable financial institution that has been in operation in Chicago for 78 years, and is widely regarded as the preeminent U.S. provider of futures clearing services to the financial and agricultural trading communities. The inability of U.S. Futures Exchange to enter the U.S. market on an expeditious basis could, as the CBOT has itself noted, lead to the demise and dissolution of The Clearing Corporation. We hope instead that, as our clearing partner, The Clearing Corporation will continue to fulfill its historic role as a leading Chicago financial institution and employer long into the future.

7. Market integrity. Our customers will enjoy the highest level of market integrity. Trading on U.S. Futures Exchange will, consistent with customer protection, be completely anonymous from the time of order entry all the way through contract settlement and delivery. U.S. Futures Exchange will have a full, immediate, and unalterable audit trail of all activity and transactions that occur on the trading platform. In addition, U.S. Futures Exchange has contracted with the National Futures Association to conduct market and trade practice surveillance, and to perform other regulatory duties for the exchange. The National Futures Association is a highly respected CFTC-licensed self-regulatory organization and is widely recognized as the leading provider of outsourced self regulatory services to U.S. futures exchanges.

8. Fair governance. U.S. Futures Exchange intends to establish and implement a representative governance structure that will reflect a diverse cross section of market users. The Board of U.S. Futures Exchange is expected to comprise 12 representatives, including six representatives of the various user groups. U.S. Futures Exchange also intends to base its corporate governance infrastructure on the principle of responsiveness to the views and concerns of all categories of market participants, without discriminatory bias in the decisionmaking process.

In this connection, U.S. Futures Exchange will comply with all corporate governance requirements applicable under U.S. law to U.S. futures exchanges generally. As or perhaps even more significant, Eurex's governance structure will eliminate the structural factors that lead to significant conflicts of interest and reduce the potential for abusive conduct of the type that afflicts many exchanges in the U.S., including major U.S. futures exchanges. We believe that independent governance, together with an open market model, is a particularly powerful means of discovering and meeting customer and market needs, while maximizing fair treatment of market users and shareholders.

We also intend to broaden our shareholder base through an equity partnership with U.S. market participants and have reserved a significant stake of the company's equity for this purpose. We foresee substantial industry participation in the exchange's governance.

Demand for and Impact of Competition

We believe, based on our experience, that U.S. market users are receptive to this market model. Indeed, we believe that there is significant demand for this model and that many U.S. market participants would welcome the opportunity to trade U.S. and European contracts on a designated contract market having the characteristics described above. Moreover, it is widely recognized that the establishment of U.S. Futures Exchange has the potential, not only to lower trading costs for U.S. market participants, but also – through competition – to be an engine for overall growth in the U.S. futures market, to the benefit of all market providers and all market users.

This view is supported by a comparison of the trading volumes in the U.S. market for bond futures and options with the corresponding European market for bond futures and options. The underlying market demand for management of interest rate risk is about the same in the United States and Europe. Back in 1998, the exchange-traded volume in bond futures and options in the U.S. dollar exchange traded derivatives market was 1.5 times larger than the trading volumes in Euro denominated bond futures and options. Today the exchange traded European derivatives market is significantly larger than the U.S. derivatives market. This demonstrates the dramatic impact that a more democratic market model, effective competition and innovation can have on growth in the market. We hope that by offering direct access to U.S. dollar denominated products to customers worldwide, U.S. Futures Exchange will both support and expand the growth of the U.S. bond futures market.

There was a period, not very long ago, when the futures industry effectively began and ended within the borders of the United States. That was because this was the only country in the world where the three basic requirements for futures trading existed in abundance:

- a critical mass of companies and individuals willing and able to use the markets efficiently;
- a tradition of operating transparent financial markets open to all; and
- a regulatory structure that protected market users without encumbering the operation of markets.

Beginning approximately 20 years ago, with the assistance of both U.S. exchanges and U.S. market participants, the idea of futures markets spread beyond the borders of this country and new markets began to develop around the world. In many ways the European exchanges modeled themselves after U.S. markets. Foreign exchanges then began to apply new methods to the trading of these products – the use of electronic trading systems for example – making it easier for a broader array of participants to participate directly in the markets. The goal was to make markets more efficient, more cost effective, more transparent – more responsive to the needs of the rapidly growing base of market users. And in doing this some European exchanges have succeeded beyond expectations – attracting traders not just from their European home markets, but from throughout the United States and the rest of the world as well. U.S. exchanges have themselves recently begun adopting that technology. The a/c/e joint venture between the CBOT and Eurex is a case in point.

Conclusion

U.S. Futures Exchange, as a U.S. designated contract market, is poised to offer U.S. investors the benefits available in non-U.S. markets, and to do so subject to the financial safety and customer protections provided by the U.S. regulatory framework. Today, U.S. customers can obtain those benefits only by trading on the global markets. Only on the global markets do U.S. customers have the opportunity to trade in a variety of Euro-denominated instruments. U.S. Futures Exchange plans to offer U.S. market participants access to such products with the support of The Clearing Corporation, and stands ready to offer U.S. products, on a fully U.S.-regulated domestic contract market, all cleared by a U.S. derivatives clearing organization. In the final analysis, our ability to enter the U.S. market will bring greater competition to the U.S. futures industry to the benefit of U.S. market participants, end-users, investors, and the U.S. futures industry itself. This was precisely the goal Congress had in mind when it enacted the Commodity Futures Modernization Act of 2000 (“CFMA”), under the leadership of this Committee.

Indeed, this Committee is rightly credited for its leadership role in connection with the legislation ultimately enacted as the CFMA, an act that established a modern and streamlined framework for the regulation of the U.S. futures markets. The CFMA is widely heralded as a paradigm for the balancing of private sector autonomy and governmental oversight interests. The premise for that legislation was the notion that the salutary effect of private sector market discipline would obviate the need for overly prescriptive governmental intervention, and its attendant inefficiencies. However, that premise depends entirely on the existence of competition. Without competition, or the conditions for competition, there is no market discipline. Without market discipline there is no market or other mechanism by which exchanges are compelled to be responsive to the needs of market participants. The absence of competition fundamentally undermines Congress’s key objectives in enactment of the CFMA and will perpetuate the imposition of real costs and inefficiencies on the investors in these markets.

It is equally important to recognize that the benefits of competition are not necessarily limited to consumers. Competition leads to innovation and efficiency. These, in turn, can be an engine for growth that expands opportunities for all competitors in the marketplace. This is true across all economic sectors – domestic and foreign. We and other observers fully expect that this will be the case in the U.S. futures markets.

We are pursuing this application precisely because there is an enormous and urgent demand from U.S. market participants, including among constituents of this Committee, for competition, greater efficiencies, greater transparency and lower costs in the U.S. futures markets. U.S. Futures Exchange is attempting to respond to this demand by competing in these markets on a level playing field, and subject to precisely the same regulatory framework as its competitors.

We are confident that this Committee will review these issues analytically and with objectivity. This Committee must not be misled by those whose sole motivation is to prevent the emergence of competition in the U.S. financial futures markets, to the detriment not only of direct participants in these markets, but ultimately to all consumers throughout the U.S. economy whose cost of living is affected by the cost of interest rate products.

We are anxious to respond to any and all questions that this Committee or the CFTC may have and we are confident in our ability to respond to the complete satisfaction of this Committee and the CFTC. We thank the Committee for the opportunity to do so.